

# Commodity Exchange Compensation Fund (the Fund)

## Report of the Futures Compensation Fund Committee (the Committee)

The members of the Committee present their annual report and the audited financial statements for the year ended 31 March 2004.

### 1. Establishment of the Fund

Part VIII of the Commodities Trading Ordinance (Chapter 250) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. After reserving sufficient money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund to the ICF.

Part VIII of the Commodities Trading Ordinance remains effective in respect of the operation of the Fund to the extent described in Section 75(1) of Schedule 10 of the SFO.

### 2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 122 to 130.

### 3. Members of the Committee

The members of the Committee during the year and up to the date of this report were :-

Mr Mark Dickens, JP

Mrs Alexa Lam

Mr William D Grossman (membership ceased on 13 May 2003)

Mr Lobo Lee (appointed on 19 May 2003 and membership ceased on 3 June 2003)

Mr Mark Ho (membership ceased on 3 June 2003)

Mr Calvin Tai (appointed on 16 June 2003)

Mr Lawrence Fok (appointed on 16 June 2003)

Mr T Brian Stevenson, SBS

### 4. Interests in contracts

No contract of significance to which the Fund was a party and in which a Committee Member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the year.

### 5. Auditors

The retiring auditors, Messrs KPMG, being eligible, offer themselves for re-appointment.

On behalf of the Committee

**Mark Dickens, JP**

*Chairman*

30 April 2004

## **Auditors' Report To The Securities & Futures Commission (the SFC)**

We have audited the financial statements of the Commodity Exchange Compensation Fund (the Fund) established under Section 77 of the Hong Kong Commodities Trading Ordinance set out on pages 122 to 130 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

### **Respective responsibilities of the SFC and auditors**

The Hong Kong Commodities Trading Ordinance requires the SFC to keep proper accounts of the Fund and to prepare financial statements of the Fund in respect of each financial year. The directors of the SFC do so on the basis that these financial statements should give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### **Basis of opinion**

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the SFC in the preparation of the financial statements and of whether the accounting policies are appropriate to the Fund's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

### **Opinion**

In our opinion, the financial statements give a true and fair view of the state of affairs of the Fund as at 31 March 2004 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

#### **KPMG**

*Certified Public Accountants*  
Hong Kong

30 April 2004

## Commodity Exchange Compensation Fund Financial Statements

### Income and Expenditure Account

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
<b>Income</b>			
Net investment income	3&5	731	6,063
Contract levy	3&6	–	6,987
Recoveries	3	–	14
		<b>731</b>	13,064
<b>Expenses</b>			
Auditors' remuneration		37	41
Bank charges		21	60
Professional fees		22	27
Sundry expenses		2	1
		<b>82</b>	129
<b>Surplus for the year</b>		<b>649</b>	12,935
<b>Accumulated surplus brought forward</b>		<b>107,613</b>	94,678
<b>Accumulated surplus carried forward</b>		<b>108,262</b>	107,613

The notes on pages 126 to 130 form part of these financial statements.

## Balance Sheet

At 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
<b>Current assets</b>			
Debt securities	7	–	75,633
Interest receivable		–	957
Levy receivable		–	772
Fixed and call deposits with banks		524	51,767
Cash at bank		5	136
		<b>529</b>	129,265
<b>Current liabilities</b>			
Accounts payable and accrued charges		227	252
		<b>302</b>	129,013
<b>Net current assets</b>			
		<b>302</b>	129,013
<b>Net assets</b>			
Representing :			
<u>Compensation fund</u>			
Contributions from the HKFE	8	–	21,400
Accumulated surplus		108,262	107,613
		<b>108,262</b>	129,013
Contributions to Investor Compensation Fund	9	<b>(107,960)</b>	–
		<b>302</b>	129,013

Approved and authorised for issue by the Futures Compensation Fund Committee on behalf of the Securities and Futures Commission on 30 April 2004 and signed on its behalf by

**Mark Dickens**  
Chairman

**Alexa Lam**  
Committee Member

**T Brian Stevenson**  
Committee Member

The notes on pages 126 to 130 form part of these financial statements.

# Commodity Exchange Compensation Fund Financial Statements

## Statement of Changes in Equity

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Compensation fund balance as at 1 April		<b>129,013</b>	116,278
Surplus for the year		<b>649</b>	12,935
Net contributions refunded to the HKFE	8	–	(200)
Contributions reimbursed to the HKFE	8	<b>(21,400)</b>	–
Contributions to Investor Compensation Fund	9	<b>(107,960)</b>	–
Compensation fund balance as at 31 March		<b>302</b>	129,013

The notes on pages 126 to 130 form part of these financial statements.

## Cash Flow Statement

For the year ended 31 March 2004  
(Expressed in Hong Kong dollars)

	2004 \$'000	2003 \$'000
<b>Cash flows from operating activities</b>		
Surplus for the year	649	12,935
Net investment income	(731)	(6,063)
Decrease / (Increase) in levy receivable	772	(291)
Decrease in accounts payable and accrued charges	(25)	(1)
Net cash from operating activities	665	6,580
<b>Cash flows from investing activities</b>		
Debt securities redeemed	23,000	51,700
Debt securities sold	51,555	–
Debt securities bought	–	(16,732)
Interest received	2,766	6,818
Net cash from investing activities	77,321	41,786
<b>Cash flows from financing activities</b>		
Net contribution refunded to the HKFE	–	(200)
Contributions reimbursed to the HKFE	(21,400)	–
Contributions to Investor Compensation Fund	(107,960)	–
Net cash used in financing activities	(129,360)	(200)
<b>Net (decrease) / increase in cash and cash equivalents</b>	<b>(51,374)</b>	48,166
<b>Cash and cash equivalents at beginning of the year</b>	<b>51,903</b>	3,737
<b>Cash and cash equivalents at end of the year</b>	<b>529</b>	51,903

### Analysis of the balance of cash and cash equivalents :

	2004 \$'000	2003 \$'000
Cash at bank	5	136
Fixed and call deposits with banks	524	51,767
	529	51,903

## Notes to the Financial Statements

For the year ended 31 March 2004  
(Expressed in Hong Kong dollars)

### 1. Purpose, limitation and principal activity

The Fund provides compensation to investors who suffer a loss due to the default of an exchange participant of the Hong Kong Futures Exchange Limited (the HKFE). Part VIII of the Commodities Trading Ordinance governs its operation.

The HKFE receives and determines claims against the Fund. The SFC maintains and invests the money of the Fund and makes payments to claimants. Upon making payment to a claimant, the SFC is subrogated to the claimant's rights against the defaulter.

The Commodities Trading Ordinance limits to \$2 million the total amount that may be paid per exchange participant default. If allowed claims exceed the limit, payments are made proportionally to claimants. The HKFE, with the approval of the SFC, can decide to increase the limit if it considers that the assets of the Fund so permit.

If amounts owed to claimants against the Fund exceed the Fund's net assets, the SFC would apportion compensation payments to claimants as provided in the Commodities Trading Ordinance. Unpaid claim amounts would be charged against future receipts by the Fund and paid when funds were available.

After the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. After allowing a sufficient sum of money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund into the ICF. Claims for any defaults occurring after 31 March 2003 shall be made against the ICF. If the sum of money in the Fund is not sufficient to meet its liabilities, the SFC shall pay into the Fund from the ICF the appropriate sum of money according to Section 242 of the SFO.

Apart from the above change and Section 89 of the Commodities Trading Ordinance, under Section 75(1) of Schedule 10 of the SFO, Part VIII of the Commodities Trading Ordinance remains effective in respect of the operation of the Fund.

### 2. Money constituting the Fund

Under the Commodities Trading Ordinance, the HKFE was required to keep deposited with the SFC \$100,000 for each holder of HKFE trading rights before 1 April 2003. The SFC has discretion to add to the Fund the investment return earned on the deposits net of Fund expenses or pay interest to the HKFE. In practice, the SFC adds the investment return to the Fund.

Other sources of money for the Fund include a contract levy chargeable on contracts traded on the HKFE before the SFO came into effect on 1 April 2003 and recoveries.

### 3. Significant accounting policies

The Fund prepares its financial statements in accordance with International Financial Reporting Standards (including applicable International Accounting Standards and Interpretations) promulgated by the International Accounting Standards Board. We set out below a summary of our significant accounting policies.

#### **Basis of preparation**

Under the SFO, the Fund will continue in operation until all claims against it and all its liabilities have been settled. As the Fund will eventually cease operation, we have prepared these financial statements on a break-up basis with assets stated at recoverable amounts. We have not provided in the financial statements for all expenses expected to be incurred subsequent to the balance sheet date and up to the date operations will cease as these are estimated to be immaterial.

#### **Recognition of income**

**Net Investment income** Net investment income comprised (i) interest income from bank deposits and debt securities, (ii) unrealised gain or loss on revaluation of debt securities and (iii) realised gain or loss on redemption and disposal of debt securities. We record interest income on an accrual basis.

**Contract levy** We record contract levy as income at a fixed rate on every leviabale HKFE transaction on an accrual basis.

**Recoveries** We record recoveries pursuant to Section 95 of the Commodities Trading Ordinance as income on a receipt basis to the Fund.

#### **Investments**

As we have prepared the financial statements on a break-up basis, we classify our investments in debt securities as current assets and state these securities at fair value with any resultant unrealised gain or loss recognised in the income and expenditure account. The fair value of the securities is their quoted bid prices at the balance sheet date. We account for purchases and sales of debt securities on the settlement date.

#### **Impairment**

We review the carrying amounts of the Fund's assets at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

##### **(i) Calculation of recoverable amount**

We calculate the recoverable amount of the Fund's receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount.

##### **(ii) Reversals of impairment**

We reverse an impairment loss in respect of a receivable if the circumstances and events that have led to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

# Commodity Exchange Compensation Fund Financial Statements

## 3. Significant accounting policies (Cont'd)

### Other receivables

We state other receivables at their cost less impairment losses.

### Provision for compensation

We make provision for compensation for known liabilities arising from claims for pecuniary losses suffered by persons as a result of defaults occurring prior to 1 April 2003 on the part of the exchange participants of the HKFE which are determined up to the date on which the financial statements are approved by the Committee. We charge such provisions as expenses through the income and expenditure account.

### Other payables

We state other payables at cost.

### Related parties

For the purpose of these financial statements, we consider that the following are related parties of the Fund :

- (i) parties that the Fund has the ability, directly or indirectly, to control or significantly influence in making financial and operating decisions;
- (ii) parties that have the ability, directly or indirectly, to control or significantly influence the Fund in making financial and operating decisions; and
- (iii) parties that are subject to common control or common significant influence.

Related parties may be individuals or corporate entities.

## 4. Taxation

Section 87 of the Hong Kong Inland Revenue Ordinance exempts the Fund from Hong Kong taxes.

## 5. Net investment income

	2004 \$'000	2003 \$'000
Interest income from bank deposits and debt securities	1,474	5,104
(Loss) / gain on revaluation of debt securities	(743)	959
Net investment income	<u>731</u>	<u>6,063</u>

## 6. Contract levy

Before 1 April 2003, the Fund received a contract levy chargeable at \$0.5 per every leviable HKFE transaction except for Mini-Hang Seng Index Futures Contracts, Stock futures contracts and Options on Stock futures contracts which are chargeable at \$0.1 per transaction. After the SFO came into effect on 1 April 2003, contract levy was paid into the ICF. No contract levy was received by the Fund for the year.

## 7. Debt securities

	<b>2004</b> <b>\$'000</b>	2003 \$'000
Maturing after one year		
In the second to third years – unlisted	–	37,318
After three years – unlisted	–	3,510
	–	40,828
Maturing within one year – unlisted	–	34,805
	–	75,633

During the year, the Fund sold debt securities of nominal value \$49.5 million to the ICF at market price.

## 8. Contributions from the HKFE

	<b>2004</b> <b>\$'000</b>	2003 \$'000
Balance brought forward	<b>21,400</b>	21,600
Add: Contributions received during the year	<b>400</b>	700
Less : Refunds to outgoing holders of trading rights	<b>(400)</b>	(900)
Less : Contributions reimbursed to the HKFE	<b>(21,400)</b>	–
Balance carried forward	–	21,400

Under Section 75(3) of Schedule 10 of the SFO, the SFC may apply any excess of the Fund over amounts necessary for satisfying claims and outstanding liabilities of the Fund to reimburse the HKFE for the amounts which the HKFE has deposited into the Fund as required under Section 82 of the Commodities Trading Ordinance. During the year, SFC reimbursed the HKFE \$21.4 million.

## 9. Contributions to Investor Compensation Fund

When the SFO and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. Under Section 75(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the ICF, which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. During the year, the SFC paid \$107,960,000 into the ICF from the Fund.

## 10. Related party transactions

We have related party relationships with the ICF, the SFC and the HKFE. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 7 to 9).

### **11. Financial instruments**

The Fund had Hong Kong dollar deposits with banks only and, as a result, was not subject to significant interest rate, foreign exchange and credit risk.

### **12. Contingent liabilities**

As at the date of this report, there is no outstanding claim against the Fund (2003 : nil).